

THE INVESTMENT COMMITTEE
OF THE
MARYLAND STATE RETIREMENT AND PENSION SYSTEM

MINUTES OF OPEN MEETING

February 21, 2023

The Investment Committee convened on Tuesday, February 21, 2023 at 9:00 am via a hybrid video-conference call/in-person meeting with the host site at the Maryland State Retirement Agency, Truist (SunTrust) Building, 120 East Baltimore Street, 16th Floor, Board Room, Baltimore, Maryland.

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| Committee Members | Linda V. Allen | Douglas Prouty |
| Attending: | Michael Barry | Anne L. Shelton |
| | James Daley, Jr. | Michael J. Stafford, Jr., Chairman |
| | Sheila Hill | Monte Tarbox |
| | Richard Norman | |

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| Also Attending: | Ray Adams | Troy Jenkins (im.avisonyoung) |
| | Sara Al-Moukadem (Wellington) | Dana Johns |
| | Phillip Anthony (MLIS) | Danita Johnson |
| | Jihwan Baek | Faina Kashtelyan |
| | Michael Baker | Greg Kasten |
| | Anish Bedi | Larry Katsafanas |
| | Frank Benham (Meketa) | Stuart Kaye |
| | Jonathan Blicher | Michael Klos |
| | Thomas Brandt (Trustee) | Ratna Kota |
| | Robert Burd, Deputy CIO | Charles Lee |
| | Antionette Butcher | Comptroller Brooke Lierman |
| | Rhett Butler | (Trustee) |
| | Teresa (Tea) Carnell, OAG | John Lawlor (Hamilton Lane) |
| | Dominique Cherry | Michael McCord |
| | Rachel Cohen, OAG | Jonathan Martin (Treasurer's liaison) |
| | Kim Cook (ssga) | Nitin Mathew |
| | Jamaal Craddock (Trustee) | Kyongdo Min |
| | Bob Diehl | Katie Moore (Hamilton Lane) |
| | Maguette Diop (seiu.org) | Mary Mustard (Meketa) |
| | Joe Ebisa (WithIntelligence) | Stephen Muturi |
| | Ben Eckroth (Hamilton Lane) | Minh Nguyen |
| | Mike Fang | Martin Noven, Exec. Director |
| | Eric Farls | Ashu Pal |
| | David Ferguson | Andrew Palmer, CIO |
| | Patricia Fitzhugh | Stephen Reilly |
| | Danielle Gaines (marylandmatters.org) | Greg Ricci |
| | Anne Gawthrop | Benjamin Robb |
| | Isabella Gentile (Meketa) | David Rongione (Audit) |
| | Lauren Giordano (Meketa) | Robert Sandlass, Jr. (Trustee) |
| | Michael Golden | Dan Schick |
| | Budget Secretary Helene Grady (Trustee) | Ben Seigel (Deputy Comptroller) |
| | Dimitri Grechenko | Rick Sullivan |
| | Kenneth Haines (Trustee) | Janet Sirkis |

Alex Harisiadis, OAG
Jeffrey Hooke (jhu.edu)
Michael Howard (Trustee)
Radhika Iyer (MorganStanley)

Kevin Slack
Frederick “Beau” Smith
Toni Voglino
Jack Wheatley

Ms. Butcher conducted a roll call to establish a quorum. Chairman Stafford called the meeting to order at 9:05 a.m.

Item 1: Ratification of Open Session Minutes

On a motion made by Mr. Prouty and seconded by Ms. Hill, the Investment Committee ratified the November 15, 2022 open meeting minutes.

Item 2: Set Preferences for Meeting Dates and Times

Mr. Stafford discussed the time and dates of future Investment Committee meetings. He said that he would prefer for the Committee to meet at an earlier time than 9:00 AM, but that may cause conflicts with other Committees. Mr. Prouty said the Governance Committee is willing to start their meetings as early as 8:00 AM.

Mr. Stafford remarked that it is preferred for Committee members to attend meetings in-person. Ms. Allen said that she did not know that in-person attendance was preferred, but that she would attend in-person in the future.

Mr. Noven noted the goal to accommodate Agency staff, vendors, and the public attending Committee meetings in-person in the future.

Item 3: Investment Division Salary Scale Adjustments

Mr. Burd presented recommendations for adjustments to the Investment Division salary scale. He said that CBIZ had recommended a 5.3% salary scale adjustment for all employees in the Investment Division with investment discretion based on the Bureau of Labor Statistics’ Employee Cost Index (ECI).

Mr. Palmer noted that the positions marked “N/A” on the presentation materials are non-investment facing and instead follow the scale adjustments provided by the Department of Budget and Management.

Mr. Daly asked which positions are the most difficult to recruit and whether a larger increase is warranted for those positions. Mr. Palmer replied that the most difficult positions to hire have been the non-investment facing positions and added that it has been less difficult to hire for senior-level investment positions than junior-level positions.

Ms. Grady asked when the Committee will receive compensation benchmarks with a peer comparison. Mr. Palmer answered that the Agency plans to issue an RFP for a compensation consultant every five years and this is scheduled to occur in 2023 as it has been almost five years since the previous compensation benchmark study was completed.

Mr. Barry asked what increase was recommended last year. Mr. Palmer answered that the recommendation last year was 3%. Mr. Barry asked if the Committee has the authority to overrule the recommendations. Ms. Cohen said that the Committee makes a recommendation to the Board of Trustees but is constrained regarding compensation for positions that follow the standard state salary scale. She clarified that the current item only relates to considering the blanket recommendation and that the Committee will vote in Closed Session on recommendations for specific positions.

Ms. Grady asked for clarification on how incentive compensation is considered. Mr. Palmer replied that incentive compensation is based on three objective criteria over a three-year lookback period.

Mr. Barry noted that the increase over the last two years has lagged inflation and he would be supportive of a larger increase.

On a motion made by Ms. Hill and seconded by Mr. Prouty, the Investment Committee voted to accept the 5.3% salary scale adjustment recommendation.

Item 4: Public Advisor Position – Call for Nominations

Mr. Stafford called for nominations for the Public Advisor position. He noted this would be Public Advisor Shelton's final Committee meeting and thanked her for her service to the System.

Comptroller Lierman recommended the Committee consider candidates who are well-versed and experienced in climate change governance and risk.

Mr. Palmer said that nominations can be submitted to him or to Mr. Noven. Mr. Palmer and Mr. Noven will interview the candidates and select up to three for the Committee to interview.

Item 5: Investment Policy Manual Draft Redlined Changes and Memo

Ms. Cherry discussed the proposed changes to the Investment Policy Manual. Mr. Palmer noted that this is the third draft of the proposed changes, the first having been presented to the Investment Committee in September 2022 and the second in November 2022.

Ms. Cherry explained that changes made from the previous draft emphasize language relating to fiduciary duty and clarify that the primary objective of the Board is achieving investment returns, defines "long-term sustainable portfolio," and limiting systemic risk.

Ms. Shelton proposed three recommendations on clarifying language.

On a motion made by Ms. Shelton and seconded by Mr. Stafford, the Investment Committee voted to approve the red-line changes with the edited suggestions from Ms. Shelton.

Item 6: Report from CIO

Mr. Palmer gave an update on the portfolio's performance. He said that the plan's -8.94% return for calendar year 2023 lagged the 6.8% actuarial return target but exceeded the policy benchmark by 184 basis points. He explained that private markets have held up better than public markets.

The System committed around \$800 million to new managers and raised around \$500 million in cash during the quarter, mostly from the Absolute Return portfolio due to the change in allocation from 8% to 6% of assets.

Mr. Stafford asked if the Committee can receive more detailed information on new manager hires. Mr. Palmer replied that a summary of new managers was provided in the material and added that providing a detailed memorandum on new manager hiring decisions may be a governance issue relating to Investment staff's discretion over manager decisions.

Comptroller Lierman said that Investment Division staff members should be confident enough in their decisions to explain those actions to the Board. Mr. Palmer replied that he is trying to find a balance in the level of information provided.

Ms. Shelton noted that the Committee has delegated authority to make manager decisions to the CIO. Mr. Stafford agreed, but added that the Committee has a right to ask questions about those decisions. Ms. Shelton expressed concern about second-guessing Investment staff's decision-making processes. Mr. Daly commented on the importance of "clean and unfettered" decision-making by staff members on investment decisions.

Comptroller Lierman asked about receiving a one-page summary of new investments. Mr. Palmer said that he can provide additional information on manager hiring.

Mr. Barry recommended that if Trustees would like to receive more information on investments, they should approach Mr. Palmer or Mr. Noven directly.

Mr. Palmer continued to review performance. He presented a breakdown of total performance attributable to allocation, selection, and style effect. Mr. Barry congratulated Mr. Palmer and his team on their longer-term outperformance.

Mr. Palmer discussed Investment Division initiatives. He explained the implementation of a new passive infrastructure portfolio managed by the public equity team. He added that he is exploring building an enhanced cash product to add incremental return in the management of excess cash.

Mr. Stafford asked for more information on the benchmarks to be included. Mr. Palmer replied that the information can be found in the Investment Policy Manual and would be included in the meeting materials in future meetings.

Mr. Stafford observed that the internally managed strategies were slightly behind in performance. Mr. Palmer replied that the team had begun with internal management of passive assets and will realize larger fee savings in the future from active internal management.

Mr. Barry asked whether there is a cap on uncalled capital or illiquid assets in the plan. Mr. Palmer replied that there is not. Mr. Barry expressed concern that the proportion of illiquid assets in the plan is high. Mr. Palmer replied that staff monitors the liquidity position and Meketa would have more information in their presentation.

Mr. Palmer discussed the timing of monthly cash disbursements to beneficiaries. He mentioned that they pay out 2-3% of plan assets per year.

Item 7: Meketa Reports

Ms. Mustard discussed the plan's performance. She said that the plan returned 3.1% for the quarter and that most asset classes had positive performance except Private Equity and Absolute Return. She noted that Private Equity and Fixed Income outperformed on a relative basis. She said that the plan was in the lowest quartile relative to peers for the quarter but was in the highest quartile relative to peers over the previous year.

Item 8: Updated Capital Market Assumptions and Asset Allocation

Mr. Benham discussed the System's asset allocation. He noted that the Board adopted a policy to conduct a comprehensive asset allocation review at least every five years, as opposed to annually. The last asset allocation review and recommendation was made in 2021. However, Meketa believes that it is prudent to revisit asset allocation again due to meaningful changes in their capital market assumptions due to higher interest rates and changing opinions regarding System's emerging market allocation.

Mr. Benham presented several asset allocation options and highlighted the recommendation to reduce exposure to emerging markets by 4% and shift 1% from TIPS to Credit. He recommended that the asset allocation change be implemented gradually over a period of 12-24 months.

Ms. Shelton raised concerns that increasing exposure to Credit would reduce liquidity. Mr. Benham responded that reducing the emerging markets allocation without increasing Credit would lower expected return. Ms. Shelton recommended lowering emerging markets allocation by 5% and not adjusting credit.

Mr. Stafford asked Mr. Palmer for his opinion. Mr. Palmer recommended reducing emerging markets exposure by 4% with half going to U.S. equity and half to non-U.S. developed markets equity. He also recommended reducing TIPS by 1% and increasing Credit by 1% as suggested by Mr. Benham. He noted that the credit allocation includes both public and private debt.

On a motion made by Mr. Barry and seconded by Ms. Hill, the Investment Committee voted to accept Meketa's recommendation to lower emerging markets allocation by 4%, with 2% being added to each of U.S. equity and international developed equity. In addition, TIPS would be reduced by 1% and the Credit allocation would be increased by 1%. These changes are to be implemented gradually based on staff's discretion, potentially over the course of 12 to 24 months.

Item 9: Hamilton Lane Report

Ms. Moore gave an update on private markets. Hamilton Lane believes there could be a period of accelerated growth while valuations are in recession. In explaining the difference between public and private market valuations, she explained that public company valuations are more strongly influenced by investor sentiment and emotion. She believes there is significant opportunity in private markets in the current environment.

Mr. Eckroth discussed the private equity portfolio. He noted that as of 9/30/2022, the private equity portfolio represented 21.6% of plan assets compared to the 16% policy target and that the larger number of commitments over the last year is attributed to a compressed fundraising cycle and an increased number of private equity co-investments.

Mr. Stafford asked for clarification about the difference between the Hamilton Lane benchmark and the State Street benchmark. Mr. Eckroth said that Hamilton Lane's benchmark is very similar to Maryland's allocation except regarding venture capital, but he is not familiar with the composition of the State Street benchmark.

Mr. Eckroth recommended lowering the pace of annual commitments to private equity to a range between \$1.5 billion and \$2 billion in order to move toward the target allocation of 16%. He said that investment staff has reduced the number of managers in the portfolio and reduced commitment sizes to achieve this goal.

Mr. Barry asked why the private equity commitment amount was significantly lower in 2021. Mr. Palmer responded that this was due to a higher number of the System's managers raising funds in 2022 instead of 2021. He added that the commitments will smooth out over time. Mr. Barry was concerned about potential overallocation to illiquid assets in the portfolio and mentioned it might be better to further reduce pacing now to prevent the risk of being boxed out of making commitments later. Mr. Palmer replied that staff had been working on stress testing portfolio liquidity.

Mr. Stafford suggested staff be more aggressive in reducing the private equity portfolio toward the target allocation.

Comptroller Lierman asked how the System should balance concentrating the portfolio against allocating to emerging managers. Ms. Moore responded that it is difficult to allocate to small managers given the current situation but that over time, underperforming managers will be pruned to make room in the portfolio for new opportunities.

Ms. Shelton asked how many years are included in Hamilton Lane's pacing model. Mr. Eckroth said that the model forecasts 15 years.

Mr. Eckroth also discussed the private credit portfolio. The portfolio represents 3.1% of total plan assets as of 9/30/2022, which is below the policy target of 4.5%. He recommended committing up to \$1.5 billion to private credit over the next several years to reach the target.

Ms. Shelton expressed concern that the \$1.5 billion proposed commitment pacing would be too much. Mr. Eckroth responded that this level of commitment would allow the credit portfolio to reach the target weight and the pacing could then be lowered to maintain the target weight.

Ms. Shelton said that the difference in the \$1.5 billion proposed commitment and the current commitment level is significant. Mr. Palmer responded that he believes the current commitment level is too low to reach the target.

Ms. Moore provided an update on the natural resources portfolio. The portfolio represented 1.7% of plan assets as of 9/30/22. Ms. Moore said that the portfolio is concentrated in energy industries, which have performed strongly.

Mr. Stafford asked about the public benchmark for the natural resources portfolio. Mr. Palmer responded that a private benchmark could be considered in the future.

Ms. Moore recommended a commitment pace of about \$1 billion per year to reach the policy target of 5%.

Item 10: Investment Reports

The Committee received the following investment reports:

- State Street Performance Reports
- Terra Maria Performance Reports
- Private Markets Performance Reports
- Securities Lending Report
- Division's FY23 Travel Plan - Update
- Quarterly ORP Performance Report
- OPEB-PHBT Update
- New Hire Manager Report

On the Directors Desk:

- Broker Commission Reports
- Quarterly Manager Fee Report

Item 11: Motion by the Investment Committee to meet in Closed Session

On a motion made by Ms. Shelton and seconded by Mr. Prouty, the Investment Committee voted without objection to meet in Closed Session at 12:24 p.m. for the purposes of:

- (a) reviewing the closed session Investment Committee minutes, pursuant to General Provisions Art., § 3-103(a)(1)(i), the exercise of an administrative function, and General Provisions Art., § 3-305(b)(13), to comply with a specific statutory requirement that

prevents public disclosure, namely, General Provisions Art., § 3-306(c)(3)(ii), requiring that the minutes of a closed session be sealed and not be open to public inspection;

- (b) reviewing a confidential schedule of fees and carried interest associated with the System's private market investments, pursuant to General Provisions Art., § 3-305(b)(13), to comply with a specific statutory requirement that prevents public disclosure, namely, General Provisions Art., § 4-335, requiring the denial of inspection of confidential commercial information, confidential financial information, and trade secrets provided by any person to a governmental unit;
- (c) considering proposed salary adjustments for employees of the Investment Division, pursuant to General Provisions Art., Section 3-305(b)(1)(i), to discuss the appointment, employment, assignment, promotion, discipline, demotion, compensation, removal, resignation, or performance evaluation of appointees, employees, or officials over whom it has jurisdiction; and
- (d) considering a proposed salary adjustment for the CIO pursuant to General Provisions Art., § 3-305(b)(1)(i), to discuss the appointment, employment, assignment, promotion, discipline, demotion, compensation, removal, resignation, or performance evaluation of appointees, employees, or officials over whom the Committee has jurisdiction, and General Provisions Art., § 3-103(a)(1)(i), the exercise of an administrative function.

Item 16: Motion by Investment Committee to adjourn closed session and return to open session

On a motion made and seconded, the Investment Committee voted to adjourn closed session and returned to open session at 1:17 p.m.

OPEN SESSION

| | | |
|-------------------|----------------------------------|------------------------------------|
| Committee Members | Linda V. Allen | Douglas Prouty |
| Attending: | Michael Barry | Anne L. Shelton |
| | James Daley, Jr. | Michael J. Stafford, Jr., Chairman |
| | Sheila Hill | Monte Tarbox |
| | Richard Norman | |
| Also Attending: | Robert Burd, Deputy CIO | Comptroller Brooke Lierman |
| | Antionette Butcher | (Trustee) |
| | Teresa (Tea) Carnell, OAG | Jonathan Martin (Treasurer's |
| | Rachel Cohen, OAG | liaison) |
| | Jamaal Craddock (Trustee) | Martin Noven, Exec. Director |
| | Treasurer Helene Grady (Trustee) | Andrew Palmer, CIO |
| | Kenneth Haines (Trustee) | Robert Sandlass, Jr. (Trustee) |
| | Alex Harisiadis, OAG | Ben Seigel (Deputy Comptroller) |
| | Michael Howard (Trustee) | Toni Voglino |
| | Michael Klos | |

Item 17: Committee Led Discussion

Nothing discussed.

Item 18: Motion by the Investment Committee to adjourn meeting

Adjournment There being no further business before the Investment Committee, on a motion made by Mr. Daley and seconded by Mr. Stafford, the meeting adjourned at 1:19 p.m.

Respectfully submitted,

Andrew C. Palmer
Chief Investment Officer